PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

Agenda ID #2023
and
Agenda ID #2057

May 9, 2003

TO: PARTIES OF RECORD IN RULEMAKING 01-10-024

Enclosed are the revised draft decision of Administrative Law Judge (ALJ) Walwyn and revised alternate draft decision of President Peevey. The revised alternate draft decision differs from the revised draft decision based on substantive changes that appear on p. 10. These items will be on the Commission's agenda for its May 22, 2003 meeting. The Commission may act then, or it may postpone action until later.

When the Commission acts on the revised draft decision or the alternate, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Public Utilities Code § 311(g)(1) requires these items to be served on all parties and subject to at least 30 days' public review and comment before the Commission may vote on them. Section 311(g)(2) and Rule 77.7(f)(9) provide that the 30-day period may be reduced or waived by the Commission upon a finding of public necessity. The comment period on these items is being shortened under this authority.

Comments on these items shall be filed and served by May 15, 2003 as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at http://www.cpuc.ca.gov. Pursuant to Rule 77.3 comments shall not exceed 15 pages. In addition, comments must be served separately on the ALJ and all Commissioners, preferably by hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKIN
Angela K. Minkin, Chief
Administrative Law Judge

ANG:tcg

Enclosures

Decision **REVISED DRAFT DECISION OF ALJ WALWYN (Mailed 5/9/2003)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Establish Policies and Cost Recovery Mechanisms for Generation Procurement and Renewable Resource Development.	Rulemaking 01-10-024 (Filed October 25, 2001)

SOUTHERN CALIFORNIA EDISON COMPANY'S FEBRUARY 3, 2003 PETITION FOR MODIFICATION OF DECISION 02-12-074

Summary

In this decision, we grant in large part Southern California Edison Company's (SCE) February 3, 2002 Petition for Modification of Decision (D.) 02-12-074. The requested relief we grant is to (1) eliminate Standards of Conduct 6 and 7; (2) specify for SCE a dollar amount for the disallowance cap under Standard of Conduct 4; (3) provide additional descriptive language for SCE on the operation of our adopted Consumer Risk Tolerance (CRT) protocol that clarifies SCE can enter longer term forward energy, gas, and other procurement hedges that are necessary to serve expected load, mitigate anticipated power conditions, and / or take advantage of cost-effective market opportunities; and (4) modify the standard for negotiated bilateral contracts for transactions entered into 31 days or less in advance of need with terms of one-calendar month or less.

In all other respects, SCE's petition is denied.

I. Background

On February 3, 2003, SCE filed a Petition for Modification of D.02-12-074. In its petition, SCE requests six changes to the rules established by the Commission to govern SCE's, Pacific Gas and Electric Company's (PG&E) and San Diego Gas & Electric Company's (SDG&E), 2003 short-term procurement plans. These requested changes are:

- Specifically establish the disallowance cap provided in Ordering Paragraph 25 at $35 million for SCE and specify that the cap should be applied to the reasonableness of the Investor Owned Utilities' (IOU) compliance with their filed procurement plans, in addition to reasonableness of contract administration and least-cost dispatch under Standard of Conduct #4 (SOC#4);
- Delete Standard of Conduct 6 (SOC6), which requires that procurement contracts be subject to Commission modification;
- Delete Standard of Conduct 7 (SOC7), which requires that suppliers submit themselves to the Commission's discovery requests;
- Eliminate the Consumer Risk Tolerance protocol in its entirety, or in the alternative, modify it;
- Modify Ordering Paragraph 25, by inserting the clause "Notwithstanding Conclusion of Law 6," at the beginning; and
- Eliminate the unworkable and unattainable "strong showing" standard for rate recovery of bilateral contract transaction costs, and instead adopt the up-front, achievable standards proposed in SCE's November 12, 2002 Procurement Plan for these transactions.

On February 7, 2003, SCE filed a Motion for Expedited Consideration of its February 3, 2003 Petition for Modification. The Office of Ratepayer Advocates (ORA) filed an opposition to SCE's motion on February 10, 2003, requesting that the time for parties responses to the petition for modification be shortened only

to February 21, 2003. ORA's request was granted by electronic ruling on February 13, 2003. ORA did not file a response.

On March 5, 2003, The Utility Reform Network (TURN) and The Natural Resources Defense Council (NRDC) filed a response that generally supports most of SCE's requests. On April 1, 2003, TURN filed a Motion for Acceptance of Late Filing stating the attorney preparing the March 5 response was not aware the time for response was shortened, SCE is not prejudiced by the late filing and no party has complained. For good cause shown, we grant TURN's motion.

II. Discussion

1. Disallowance Cap

SCE requests two modifications to the disallowance cap: to quantify the dollar amount of the cap; and to significantly expand the scope of the cap. It asserts that the total level of the disallowance cap and the costs to which it applies must be clarified in order to provide certainty to the investment community and the respondent utilities. By providing the requested modifications to D.02-12-074, SCE states the Commission will foster SCE's creditworthiness, thereby reducing the costs borne by its customers.

We address each request individually.

(a) Dollar Amount of the Cap

First, it requests that the Commission establish a dollar level for the maximum annual potential disallowance for violation of Standard of Conduct 4 (SOC#4). Ordering Paragraph 25 of D.02-12-074 states:

> "We set an annual maximum potential disallowance for violation of standard #4 at twice each utility's annual expenditures on all procurement activities. Setting this maximum amount supercedes, to the extent that it is not

> consistent with, any decision on DWR and utility operation agreement or orders issued in this docket."

SCE requests that the Commission determine that its annual expenditures on all procurement activities are $18.4 million, the amount included in its 2003 General Rate Case for the Energy Supply and Management Department (ES&M). SCE states that this amount is based on recorded data for 1996 through 2000, adjusted for the fact that many of the energy procurement responsibilities currently being performed by the California Department of Water Resources (DWR) will be assumed by ES&M personnel. SCE asserts that with the exception of Demand Side Management (DSM) programs, all procurement related activities are included within this category. Further, it states that while a substantial portion of the $18.4 million will be dedicated to SCE's resumption of procurement responsibilities, not all of these funds are attributable to those responsibilities. SCE asserts that doubling the ES&M filed amount results in a disallowance cap for 2003 of $35 million. SCE requests that Ordering Paragraph 25 be modified to state the maximum disallowance cap for SCE is $35 million.

TURN states that while it does not support the concept of a disallowance cap in the first place, for the purposes of violations of SOC4 it finds it makes sense that the magnitude of the cap be clear and unambiguous. It does not endorse any specific figure for this purpose.

In its February 21, 2003 response, PG&E agrees with SCE that establishing the cap at a stated dollar amount is a highly desirable step for keeping potential reasonableness exposure from hindering its return to creditworthiness with investment grade ratings. PG&E states it has requested approximately $17.8 million dollars in direct costs for its procurement-related

administrative expenses in its pending general rate case (GRC) and therefore requests its disallowance cap be set at $36 million. In its April 11, 2003 comments on the draft decision, SDG&E supports SCE's request for a specific dollar amount but does not request a specific dollar figure for itself.

We find that it is reasonable to adopt a specific dollar figure for the disallowance cap for violations of SOC4. Based on the formula adopted in D.02-12-074, and rounding to the nearest million, we should set a disallowance cap of $37 million for SCE and $36 million for PG&E.[1] Therefore, we should modify the D.02-12-074 to include these current dollar amounts, together with a statement that the dollar amount of each utility's disallowance cap should be reviewed in its GRC and revised in that decision. This approach provides regulatory certainty as to the magnitude of the cap.

(b) The Scope of the Disallowance Cap

SCE's second request for modification of the disallowance cap is to expand the scope of the cap to include all procurement transactions and activities. SCE's language includes under the cap all procurement transactions that had been found both to be noncompliant and unreasonable, unless the Commission can make and sustain a finding of "gross negligence" or "willful misconduct."[2]

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[1] While SDG&E did not propose a specific dollar figure, we can and should do this in the Commission's decision on its pending cost of service application.

[2] SCE does not define the legal definition we would use for a finding of "gross negligence" and "willful misconduct". It appears it would be a very high standard to meet, and SCE has shifted the burden of proof to other parties. The only time the Commission used gross negligence in the context of energy reasonableness review is when we adopted interim rules for approving long-term gas contracts under an

Footnote continued on next page

PG&E and SDG&E support the relief requested by SCE and advance the new argument that D.02-12-074 already places all procurement activity under the definition of contract administration and least-cost dispatch and, therefore, within the disallowance cap. They urge the Commission to find in support of this interpretation.

TURN opposes expanding the disallowance cap to apply to an even larger range of utility activities. It states ratepayers should not be forced to bear unreasonably incurred costs simply to improve the utility's credit status and questions whether it would even be lawful for the Commission to allow unreasonable costs to be included in a utility's rates. NRDC does not take a position on this issue.

We find SCE's proposed modification, as well as PG&E's and SDG&E's position, very troublesome because the language, if taken to an extreme, nullifies the effectiveness of each utility's adopted procurement plan and exposes ratepayers to extreme risk.

The Commission addressed the issues of the disallowance cap and what is included in its scope on December 17, 2002 in two decisions: D.02-12-069 and D.02-12-074. In D.02-12-069, the Commission adopted the Operating Order

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expedited application (EAD) procedure in D.92-11-052. In this decision, we found that our standards of review for contract approval should not change and that the utilities should assume cost responsibility for 25% of the difference between contract and tariff rates. Based on this, decisions under the EAD process would include a finding that the contract is prudent and would be dispositive of all prudence questions which might arise at a later date absent a showing of: (1) Misrepresentation or omission of material facts of which the utility is aware in connection with the utility's request for contract approval; (2) Gross negligence in determining whether a realistic threat of bypass exists; or (3) Imprudence in the utility's performance under the negotiated agreement.

under which PG&E, SDG&E, and SCE would perform the operational, dispatch, and administrative functions for the California Department of Water Resources (DWR) long-term power purchase contracts as of January 1, 2003. In Section XI of the order we reaffirmed, consistent with the language in AB 57, Section 1, (d), that the reasonableness of the utilities' administration of the DWR contracts we allocate to the utilities, including how they elect to dispatch the contract power quantities relative to other resources in their portfolio, should be at issue over the life of the contracts.[3] We then adopted a definition of prudent contract administration and least-cost dispatch that was the same as that before the Commission in its proposed decision on the procurement plans (later D.02-12-074), with the additional clarification that prohibited utility conduct under the least-cost dispatch standard includes any action that results in inappropriate preference for utility retained generation (URG) resources or the utility's own negotiated contracts.[4] Finally, on the issue of a disallowance cap, we found that the cap proposed by the utilities did not adequately reflect the level of ratepayer risk and we denied the request.[5]

In D.02-12-074, the Commission revisited the issue of a disallowance cap for contract administration and least-cost dispatch. We adopted a disallowance cap of twice the magnitude under consideration in D.02-12-069, stating that this limit supercedes, to the extent that it is not consistent with, any

[3] See D.02-09-053, mimeo. at page 7.

[4] D.02-12-069, mimeo. at page 61.

[5] Id at pages 59-60.

provisions of the operating order decision (D.02-12-069). Our justification for adopting the cap is:

> Although the historical disallowance exhibits prepared by each utility show prudent contract administration and least-cost dispatch were not the cause of significant penalties in the past and we do not expect them to be in the future, we believe that setting an upper limit on disallowances gives utilities and the investment community certainty in estimating the magnitude of potential financial risk, in order to support the utilities' quicker return to creditworthiness." (Mimeo. at page 53.)

We further stated that in adopting the cap, "We do not, however, approve the portions of the utilities' procurement plans that change standard #4's'requirements through changing our existing review standards or by shifting the burden of proof." (Mimeo. at page 54.) We also clarified, to the extent that there was any doubt, that in determining whether utilities have dispatched resources in compliance with SOC#4, contract terms or prices will not be at issue.

We agree with SCE, and therefore disagree with PG&E and SDG&E, that the existing scope of SOC#4 does not encompass all procurement activities. The fact that all procurement activity is not covered under SOC#4 is clearly seen by the two different compliance review procedures we adopted. Both December 17, 2002 decisions incorporate the procedural forum set in D.02-10-062 for reviewing the reasonableness of contract administration and least-cost dispatch; this forum is each utility's mid-year Energy Resource Recovery Account (ERRA) application.[6] D.02-10-062 sets a different procedural process for

[6] See D.02-10-062 at page 65 and D.02-12-069 at page 63.

reviewing the products purchased, transaction types, and contract terms and prices; this forum is that the utilities file a quarterly compliance advice letter within 15 days after the end of each quarter detailing all transactions in compliance with the adopted plan.[7] If a transaction falls outside of the approved plan, the utility should file an expedited application[8].

PG&E's assertion that SOC4's contract administration and least-cost dispatch encompass all procurement activity is contrary to its position in D.02-12-074 and now in its comments on SCE's petition to modify D.02-12-069.[9] In both these instances, PG&E argues for a very narrow scope for SOC#4 in order to restrict the scope of after-the-fact reasonableness review, thereby limiting the potential risk of disallowances. In its comments here, PG&E argues for broadening the scope of SOC#4 to cover all transactions. The thrust of its argument again, is to limit its exposure to potential disallowances.

PG&E's and SDG&E's arguments that all procurement activity is covered under SOC#4 are based on the detailed guidance we provided in D.02-12-074, at the request of PG&E, to the upfront standard for prudent contract administration and least-cost dispatch. The specific sentence at issue is: "In

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[7] At the request of all respondent utilities, the Executive Director granted an extension until May 1, 2003 for the first quarterly compliance filings.

[8] D.02-10-062 at 49.

[9] See D.02-12-074, at page 49, discussing PG&E's November 20, 2002 Petition to Modify D.02-10-062. A related filing is also PG&E's Application for Rehearing of D.02-10-062. In its April 7, 2003 comments on SCE's Petition to Modify D.02-12-069, at page 3, PG&E states that it "also agrees with SCE that the purchase of economic short power and the disposition of economic long power do not belong in the Commission's reasonableness review of the utility's administration and dispatch of DWR contracts."

administering contracts, the utilities have the responsibility to dispose of economic long power and to purchase economic short power in a manner that minimizes ratepayer costs."[10] We do not find that this sentence leads to the conclusion that all procurement activity is under SOC#4's review.

The sentence should be read to mean that the prudence of each utility's decision to dispatch resources contained in the integrated DWR-IOU portfolio and execute market transactions for economic purposes is part of the review under SOC#4. We reiterate from D.02-10-069 that as part of the least-cost portfolio management standard, prohibited utility conduct under the standard includes any action that results in inappropriate preference for URG resources or the utility's own negotiated contracts. Whereas the SOC#4 review focuses on utility decisions to dispatch DWR-IOU supply resources and transact in the market, the type of any product purchased or sold, together with the bidding or other transaction procedure followed, and the contract's terms and price will be reviewed in the quarterly compliance Advice Letter filings. Examples of items not included in the disallowance cap for SOC4 review include: gas procurement activities for the utilities' DWR contracts, including hedging transactions (these items will be reviewed within the framework of the to-be-adopted Gas Supply Plans); gas procurement activities, including hedging transactions, in support of new contracts, URG resources, and QF contracts (to be reviewed as part of the quarterly compliance review of the procurement plans); and the reasonableness review of URG expenses ordered in D.02-04-016 and cited in D.02-10-062 at page 65.

[10] D.02-12-074 at 52-53.

When the Commission adopted a disallowance cap for contract administration and least-cost dispatch, it clearly stated that it was at a dollar level it did not expect actual disallowances would reach and was done solely for the purpose of providing financial certainty to the investment community. The same finding cannot be made if we extend a $37 million cap to all procurement activities. Approving a disallowance cap for the purpose of allowing unreasonable costs to be recovered in rates, as SCE's requests here, violates the legal requirement of Public Utilities Code Sections 451 and 454.5(d)(5) that all rates be just and reasonable.

We begin this analysis by looking at the magnitude of dollars at issue. We calculate that SCE alone could spend $5.6 billion on 2003 procurement activities, based on its estimates of its 2002 generation revenues, excluding DWR revenues.[11] This amount is substantially higher if multi-year contracts are included in a single year's disallowance cap.[12] Under SCE's proposal, ratepayers would be at risk for all noncompliant and unreasonable procurement undertaken by the utilities, less an approximately $37 million disallowance cap.

The primary purpose in adopting upfront procurement standards was to give the utilities "up front" certainty before executing transactions, as to the applicable standards under which rate recovery will be granted. By providing the up-front the standards under which the each utility's performance would be

[11] See SCE's 7/29/02 Opening Brief, page 84, footnote 208

[12] SCE does not clarify if a multi-year contract is subject to a disallowance penalty for each year of the contract or only for the year in which it was entered. If the latter interpretation is used, the net present value of just one multi-year contract would often exceed the $36 million cap.

reviewed, the Commission would eliminate, as much as possible, the need for "after-the-fact" reasonableness reviews.[13] This is the clear legislative directive of AB 57.

In D.02-12-074, we adopted procurement standards that are sufficiently detailed and measurable to ensure our policy objectives are met, but avoided prescriptive approaches that prevent utility management from having the flexibility necessary to manage their portfolios for the ratepayers' benefit. Each utility's compliance with its adopted plan is reviewed in a timely and broad manner through quarterly advice letter filings.

In our compliance review, we do not intend to nickel and dime the utilities with a narrow assessment of each transaction. If we find a deviation from the adopted plan that warrants further attention, the utility will be provided an opportunity to explain its actions, and why it believes its action complies with the adopted plan, before the Commission decides what remedy, if any, is appropriate.

Public Utilities Code Section 702 requires each of the respondent utilities to comply with their adopted plans. Setting a disallowance cap for utility actions that are in noncompliance with their plan causes the utility, if tempted to perform some unreasonable action, to weigh the maximum possible penalty against the potential gain and perhaps chose to ignore the standards we set.

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[13] We note that the Commission has oversight over all utility operations and, therefore, should conduct some form of review of all utility activity. We did not draw a bright line between the terms compliance review and reasonableness review. Section 454.5(h) does speak to instances where the Commission should make disallowances. We note that SCE is requesting the Commission conduct **both** a compliance review and a reasonableness review of all procurement transactions and activities.

Expanding the scope of the disallowance cap to all procurement activity would apply, in the case of SCE, a $37 million disallowance cap to billions of dollars of procurement activity. This would render the adopted plans toothless and effectively nullify Section 702. This would also call into question the considerable time and resources that the Commission's staff and interested parties have devoted to the procurement planning process in the last year, and are scheduled to be allocated to review of the new plans in the coming months.

The utilities' comments on this petition show that they are highly risk adverse and seek to shift the financial risk for transactions they may chose to enter that are not in compliance with their adopted plan onto their customers. They do this in two ways: (1) requiring protracted litigation to establish a disallowance; and (2) placing a dollar limit on potential disallowances. In pursuing this proposal they make no assessment of the potential financial risks this shifts to customers, nor of the tolerance of ratepayers for these risks.

Based on the reasons discussed above, we should deny SCE's request to expand the scope of the disallowance cap.

2. Standards of Conduct 6 and 7

SCE requests that the Commission delete Standards of Conduct 6 and 7 because it precludes its ability to successfully negotiate and execute power transactions with a significant majority of potential suppliers who refuse to enter agreements that contain the language of SOC6 and / or SOC7; if the Commission does not grant this relief, SCE requests at a minimum we at least carve out an exemption for tariff contracts that are governed by tariffs.

SOC6 requires that utility procurement contracts with terms between 12 and 60 months contain a provision stating "in the event of statutory or federal

regulatory changes, this contract shall be subject to such changes or modifications as the Commission may direct."

SOC7 states that "all parties to a procurement contract must agree to give the Commission and its staff reasonable access to information within seven working days, unless otherwise practical, regarding compliance with (the Commission's) standards." In D.02-12-080, the Commission suspended the requirement to include SOC7 in contracts for first quarter 2003 transactions and then, in response to an emergency petition from PG&E, we suspended SOC7 through the first quarter of 2004 in D.03-02-034. SCE states that while the Commission has narrowed and clarified both standards, they remain vague. However, even with further revision, SCE asserts that counterparties will continue to find the standards of conduct unacceptable.

TURN and NRDC state they understand and appreciate the concerns that prompted the Commission to establish these two standards. Unfortunately, in today's environment, where many of these suppliers are currently involved in litigation with the Commission or other agencies, these provisions are commercially unacceptable to market participants. Further, while TURN and NRDC would like to be able to suggest alternative language that would stand the test of commercial practicality, they have not been able to come up with any. Therefore, until commercially acceptable alternative language can be developed, TURN and NRDC support removal of the standards.

When the Commission first adopted SOC6 and SOC7 in October 2002, we stated:

> "The abuses of energy companies during California's energy crisis are still being uncovered and investigated. The magnitude of these abuses clearly affirms the need for strong standards and vigilant oversight of energy procurement

> practices and the need for the Commission to investigate and act at any time if standards are violated." (D.02-10-062, p. 50.)[14]

Since D.02-10-062, we have tried in three decisions to narrow the standards in a manner that would be commercially acceptable to suppliers. Neither SCE, TURN or NRDC can suggest alternative language that would be commercially acceptable. We have an opportunity to re-examine this issue in the upcoming procurement hearings. Therefore, it is reasonable to eliminate SOC6 and SOC7 and look to the long-term procurement plans, where purchase power agreements for terms up to 20 years will be at issue, to further explore alternatives. Since SOC6 and SOC7 are commercially unacceptable to the majority of energy suppliers, we encourage them to propose alternative language and/or mechanisms to fully address our concerns.

3. Consumer Risk Tolerance Mechanism

SCE states that the practical effect of the Consumer Risk Tolerance (CRT) protocol is to eliminate its ability to execute forward transactions and the CRT protocol is in direct conflict with D.02-12-069 because it prevents SCE from entering into the necessary forward hedges to manage the gas price risk of the DWR contracts it administers. It requests that the Commission modify D.02-12-074 to either eliminate the CRT protocol or, in the alternative, to have it only apply to contracts for delivery of power in excess of one year. SCE provides illustrative examples of its assertions in the confidential version of its petition.

[14] On March 26, 2003, the Federal Energy Regulatory Commission announced that its two-year investigation had established that there was widespread market manipulation by energy traders during the California energy crisis.

TURN and NRDC state that the concept of customer risk tolerance is an important factor in a rational risk management strategy. The specific CRT level adopted by the Commission in D.02-12-074 was proposed by TURN. However, there has been considerable confusion surrounding the implementation of this mechanism and TURN notes that each of the three utilities has interpreted the provision very differently. TURN supports SCE's alternative recommendation to modify the CRT to state that it should not be interpreted in such a way as to bar the utilities from entering into forward transactions that are necessary to serve expected load or mitigate anticipated surplus power conditions up to one year from the date of the transaction. TURN states this proposal is entirely consistent with what it had originally intended by the CRT proposal adopted in D.02-12-074.

The Commission's Energy Division staff have reviewed the manner in which each utility applies the CRT protocol and found that SCE is misinterpreting how the CRT protocol should be applied. The misinterpretation appears to arise from SCE not having access to the confidential evidence the Commission relied on in adopting this mechanism. Staff has explained their findings to the utility and we here provide a detailed explanation of how to apply the mechanism in a revised confidential Appendix B to D.02-12-074 (this appendix modifies SCE's short-term procurement plan for 2003).

The clarification we provide gives SCE the flexibility to enter longer term forward energy, gas, and other procurement hedges that are necessary to serve expected load, mitigate anticipated power conditions, and / or take advantage of cost-effective market opportunities. The Commission will be looking further at risk management tools in the upcoming Energy Division workshop on Measures

of Portfolio Risk Exposure to be scheduled for April 2003 and in this summer's procurement hearings.

Our revision to Appendix B of D.02-12-074 is filed under seal and subject to the May 1, 2002 protective order governing access to and the use of all protected materials. Utilities are not authorized access to each others' appendices. SCE should obtain a copy of its appendix from Chief Administrative Law Judge (ALJ) Angela Minkin, or her designee, and is responsible for providing copies to all individuals authorized to receive this material within two days of the release of the draft decision for comment.

4. Ordering Paragraph 25

SCE asserts that Ordering Paragraph (OP) 25 of D.02-12-074 contradicts Conclusion of Law (COL) 6 of the same decision because OP 25 provides that the disallowance cap adopted supercedes the provisions of the DWR and Utility Operating Agreements, while COL 6 makes it clear that to the extent the procurement plans conflict with the procedures adopted in the DWR/Utility Servicing Agreements and Operating Agreements, the Servicing and Operating Agreements govern. The language at issue is:

> "6. Nothing in the approved procurement plans should be contrary to the procedures adopted in the DWR/utility servicing agreements and operating agreements and the underlying decisions adopting those agreements. To the extent any material in the procurement plans filed by the respondent utilities is contrary to the referenced agreements and decisions, those sections are not approved here."
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> "25. We set an annual maximum potential disallowance for violation of standard #4 at twice each utility's annual expenditures on all procurement activities. Setting this

> maximum amount supercedes, to the extent that it is not consistent with, any decision on DWR and utility operating agreements or orders issued in this docket."

TURN and NRDC state that they do not see a conflict between OP 25 and COL 6 because they address different subjects, and do not support SCE's request on this issue.

We also do not find a conflict between OP 25 and COL 6. COL 6 makes clear that nothing in the adopted procurement plans should be implemented in a manner that is contrary to the provisions adopted in the DWR/utility servicing agreements and operating agreements and the underlying decisions adopting those agreements. The reason this clarification is given in COL 6 is that the Commission moved in an expedited and simultaneous manner to review and adopt the procurement plans and operating orders. This is different from OP 25, where the Commission makes a policy decision that was not addressed in the procurement plans. Finding no conflict between COL 6 and OP 25, we therefore deny SCE's requested modification.

5. Standard for Bilateral Contracts

SCE requests that the Commission modify D.02-12-074 to remove the upfront standard it adopted for negotiated bilateral contracts because it is unachievable and, instead, adopt SCE's proposed standard for negotiated bilaterals from its November 12, 2003 Modified Short-Term Procurement Plan as an alternative to the current standard.[15]

D.02-12-074 requires that the utilities demonstrate through a "strong showing" that bilateral transactions represent a reasonable approximation of

[15] The Commission in D.02-12-074 found this proposal insufficient.

what a transparent competitive market would produce. Further, this "strong showing" can be met by a "comparison to Requests for Offers (RFOs) completed within one month of the transaction." SCE states this standard is impractical given the dozens of system balancing transactions it enters into every day at different times of the day for different (non-standard) blocks of hours for delivery in the near-term. According to SCE, direct bilateral contacting is the only way for an IOU to obtain or sell these types of short-term, non-standard products from the marketplace and that a transparent competitive market for such products does not exist.

TURN and NRDC offer a middle ground on this issue. They are sympathetic to SCE's problem with applying the standard to short-term specialized products that it must purchase (or sell) on a daily basis to keep its system in balance. However, they also understand why the Commission found SCE's original "standards and criteria" so vague as to represent no standard at all. TURN proposes the following: to eliminate the "strong showing" standard only for transactions less than 31 days in advance of need or for products less than one calendar month in duration.

Given the difficulties encountered by SCE for the specific transactions discussed, we find that it is reasonable to waive the strong showing standard for negotiated bilaterals for non-standard products procured 31 days or less in advance of need and with terms of one-calendar month or less. Although we waive the strong showing standard for these transactions, the utilities should demonstrate that such transactions are reasonable based on available and relevant market data supporting the transaction. This may include, showing competing price offers, results of market surveys, broker and online quotes, and / or other sources of price information such as published indices, historical

price information for similar time blocks, and comparison to RFOs completed within one month of the transaction.

We maintain the strong showing standard for negotiated bilaterals for transactions of products executed more than 31 days in advance of need and longer than one-calendar month in duration. In instances where it is known that non-standard energy products are needed to serve load on a forward and recurring basis in advance of short-term system balancing, we strongly encourage the utilities to transact for such products using an RFO process.

III. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Christine M. Walwyn is the assigned ALJ in this proceeding.

IV. Reduction of Time for Comments on the Draft Decision

Pursuant to Rule 77.7(f)(9) of the Commission's Rules of Practice and Procedure, we determine that the public necessity requires reduction of the 30-day period for public review and comment because failure to timely adopt a final decision could cause SCE to delay entering into necessary forward energy and gas hedges.

Based on the comments received, changes are made to the draft decision in the sections on Standards of Conduct #6 and #7, the disallowance cap and bilateral contracts. A revised draft was mailed on May 9, 2003, with comments due on May 15, 2003.

Findings of Fact

1. It is reasonable to adopt a specific dollar figure for the disallowance cap for violations of SOC4 in Ordering Paragraph 25.

2. SCE's request to expand the disallowance cap established in D.02-12-074 to include all procurement activities would put its customers at extreme risk.

3. Standards of Conduct 6 and 7 are commercially unacceptable to a significant majority of energy suppliers and SCE and TURN state they are unable to offer alternative language that would be acceptable.

4. Confidential Appendix B of D.02-12-074 should be modified in order to provide SCE a detailed explanation of how to apply the CRT protocol adopted by the Commission.

5. Given the difficulties encountered by SCE for specific transactions, we should waive the strong showing standard for negotiated bilateral contracts for non-standard products procured 31 days or less in advance of need and with terms of one-calendar month or less.

Conclusions of Law

1. SCE's request to expand the disallowance cap established in D.02-12-074 to include all procurement activities violates the legislative mandate of Assembly Bill 57, as codified in Pub. Util. Code § 454.5, as well as Sections 451 and 702.

2. The Commission should adopt alternative language or proposals to Standards of Conduct 6 and 7 in the utilities' long-term procurement plans. With this matter scheduled for resolution by the end of 2003, it is reasonable to eliminate Standards of Conduct 6 and 7.

3. There is no conflict between D.02-12-074's Ordering Paragraph 25 and Conclusion of Law 6.

4. Pursuant to Rule 77.7(f)(9) we reduce the period for public review and comment due to public necessity.

O R D E R

IT IS ORDERED that:

1. The Utility Reform Network's April 1, 2003 Motion for Acceptance of Filing is granted.

2. The February 3, 2003 Petition for Modification of Decision (D.) 02-12-074 filed by Southern California Edison Company (SCE) is granted in part.

3. D.02-12-074 is modified as follows:

   a. Ordering Paragraph 25 is modified to read: We set an annual maximum potential disallowance for violation of Standard #4 at twice each utility's annual expenditures on all procurement activities. For SCE this amount is $37 million based on its 2003 General Rate Case request for $18.4 million in administrative and general expenses for the Energy Supply and Management Department. For PG&E this amount is $36 million based on its 2003 General Rate Case request for $17.8 million dollars. For SDG&E this amount shall be specified in the Commission's decision on its pending cost of service application. The specific dollar amounts for each utility shall be reviewed, and revised if appropriate, in each general rate case or cost of service proceeding. Setting this maximum amount supercedes, to the extent that it is not consistent with, any decision on Department of Water Resources and utility operating agreements or orders issued in this docket.

   b. Standards of Conduct 6 and 7 are eliminated.

   c. Appendix B should be modified to provide SCE a detailed explanation of how to apply the Consumer Risk Tolerance protocol adopted for the three utilities. A revised Appendix B is filed under separate seal.

   d. We waive the strong showing standard for negotiated bilateral contracts for non-standard products procured 31 days or less in advance of need with terms of one-calendar month or less. Although we waive the strong showing standard for these transactions, the utilities should

demonstrate that such transactions are reasonable based on available and relevant market data supporting the transaction. This may include showing competing price offers, results of market surveys, broker and online quotes, and / or other sources of price information such as published indices, historical price information for similar time blocks, and comparison to RFOs completed within one month of the transaction. We retain the strong showing standard for all other bilateral transactions.

4. In all other respects, SCE's February 3, 2003 Petition for Modification of D.02-12-074 is denied.

This order is effective today.

Dated _____, at San Francisco, California.